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In the Supreme Court of the United States
OCTOBER TERM, 1971

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE UNITED STATES

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On June 14, 1971, after we filed our opening brief in the instant case, this Court decided *Commissioner v. Lincoln Savings and Loan Assn.*, No. 544, 1970 Term, for the government. We file this supplemental brief because we believe that the decision in *Lincoln* requires a decision for the government here.

I

The issue raised in the two cases, though arising on different facts, is essentially identical. In *Lincoln*, the taxpayer, a savings and loan association, in order to obtain current insurance on its depositors' accounts,

was required by federal statute¹ both to make contributions to the Secondary Reserve of the Federal Savings and Loan Insurance Corporation ("FSLIC") and to pay regular annual insurance premiums. The latter concededly were deductible as ordinary and necessary business expenses. The taxpayer sought also to deduct the contributions as business expenses.

In the instant case, the respondent farm cooperatives, in order to fulfill their current obligations on their loans from the New Orleans Bank for Cooperatives (the "Bank"), were required by federal statute both to purchase Class C stock from the Bank and to pay the stated interest on their loans. The latter concededly is deductible as interest. They seek also to deduct the cost of the stock, in excess of a nominal value of \$1 per share, as interest, or alternatively as business expenses. Here, as in *Lincoln*, our position is that the payments in dispute result in the creation of an asset having a useful life extending substantially beyond the close of the taxable year, and that these payments are therefore nondeductible capital outlays.

II

The considerations which led this Court to conclude in *Lincoln* (slip op. 10) that the taxpayer's contributions to FSLIC's Secondary Reserve served "to create or enhance for Lincoln what is essentially a separate

¹ Section 404(b) and (d) of the National Housing Act, c. 847, 48 Stat. 1246, Title IV, as amended by Secs. 3, 4, 5 and 6 of the Act of September 8, 1961, P.L. 87-210, 75 Stat. 482 (12 U.S.C. 1727(b) and (d)).

and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature * * * are present in the instant case. They require the same conclusion with respect to respondents' contributions to the Bank's capital.

Here, as in *Lincoln*, the payments in dispute are "subject to positive and rigid continuing controls" (slip op. 10). Respondents' contributions to the Bank's capital are available only to meet losses, and only then to the extent that the Bank's current earnings, loss reserves and allocated surplus are insufficient for that purpose. Moreover, now that all of the Bank's Class A stock has been redeemed, the Class C stock (together with the Class B stock, which is available to the public) has "complete seniority with respect to demands" upon the Bank, and "is the last asset called upon" (slip op. 10).

Here, as in *Lincoln*, the contributions in question provide the contributors with "a distinct and recognized property interest" (slip op. 10). Like the interest of the taxpayer in *Lincoln* in the Secondary Reserve, respondents' interest in the Bank is transferable in limited circumstances, is refundable in cash, is evidenced by a separate account on the books of the Bank, and is "an income-producing entity" (slip op. 11) in respondents' hands.²

² We have shown in our opening brief (pp. 23-28) that the Class C stock in substance earns a return. This return is strikingly similar to the statutorily required annual credit from FSLIC's earnings to each institution's share of the Secondary Reserve (see Section 404(e) of the National Housing Act (12 U.S.C. 1727(e)), in that the return, like the

Indeed, respondents' property interest in the Bank is, if anything, even more easily identifiable than the taxpayer's interest in the Secondary Reserve in *Lincoln*. As the Court explained in *Lincoln* (slip op. 10-11), the latter interest was returnable in cash only under specified circumstances—if the taxpayer terminated its insured status, went into receivership or liquidation, or at such time as FSLIC's Primary Reserve alone reached the statutorily prescribed level. In the normal course the taxpayer's share in the Secondary Reserve would not be returned in cash, but would be used to discharge its obligation to pay regular annual insurance premiums in the future. Respondents' property interest in the Bank here, on the other hand, will be returned to them in cash in all events, save only for the remote possibility that it becomes necessary to use their shares to discharge the Bank's liabilities to its creditors.

Here, as in *Lincoln*, "the presence and significance" (slip op. 11) of the property interest has been recognized. Just as "FSLIC submits annual statements to its insured institutions showing payments and credits to their respective shares" of the Secondary Reserve

credit, becomes available to its owner only at an indefinite future time. Even if the Class C stock is viewed as earning no return, it would not be proper to treat the cost of the stock as a deductible expense rather than a capital outlay. The Court in *Lincoln* did not base its holding on the credit alone. This was only one of five factors indicating that the taxpayer had "a distinct and recognized property interest in the Secondary Reserve" (slip op. 10), which in turn was only one of the several considerations leading to the Court's ultimate conclusion.

(slip op. 11), the Bank submits annual statements to its member-borrowers showing their payments for Class C stock and their patronage dividends. Moreover, as we noted in our opening brief (p. 19 n. 14, p. 20 n. 15), the Bank has always treated the Class C stock as part of its capital, and has always treated the Class C stock it purchases from the Central Bank for Cooperatives as an asset on its books. In like manner, the Central Bank has treated the Class C stock purchased by the regional banks as part of its capital (R. 211).

It is true that, unlike the taxpayer in *Lincoln*, respondents were not subject to the accounting rules of regulatory authorities, and apparently did not record the Class C stock on their books as an asset, except to the extent of \$1 per share. But the consistent accounting treatment of the stock by the Bank and the Central Bank for Cooperatives, whose officials are most conversant with the history and purpose of the governing federal statute, is, we submit, persuasive evidence of the recognition accorded respondents' property interest in the Bank. Furthermore, the Court emphasized in *Lincoln* (slip op. 11, 14) that compulsory accounting rules do not control tax consequences, and there is thus no reason to believe that the result in *Lincoln* would have been different if the taxpayer had not booked its interest in the Secondary Reserve as an asset, as required by regulatory authorities, or if its unregulated parent corporation had not followed a similar procedure.

Finally, here as in *Lincoln*, the contributor's interest "is more permanent than temporary * * * [and]

partakes more of the character of an asset than of an expense" (slip op. 12). The Court reached this conclusion in *Lincoln* with respect to both the taxpayer's share of the Secondary Reserve and the Federal Home Loan Bank stock which it was required to purchase (see slip op. 3), and which entitled it to borrow from its regional federal home loan bank up to 12 times the amount of its investment in the stock. Each, the Court said (slip op. 12), referring to the stock and to the Secondary Reserve, "is a device designed to achieve a particular and common result, namely, the providing of protection to the insured institution and to its depositors by way, in the one case, of liquidity and availability of loan funds and, in the other, by way of segregated amounts available to offset possible losses."

We have discussed in some detail in our opening brief (pp. 18-21, 28-34) what Congress set out to accomplish in enacting the Farm Credit Act of 1955, and the various long-term benefits accruing to a farm cooperative through its ownership of Class C stock. There is no need to review these aspects of the case here. It is sufficient for present purposes to point out that the Class C stock serves the same function as the Federal Home Loan Bank stock—it results in the creation of a pool of capital for the benefit of contributors to the fund. Thus, like the Federal Home Loan Bank stock, it is a device designed to provide protection to contributors "by way * * * of liquidity

³ See Section 10(c) of the Federal Home Loan Bank Act, c. 522, 47 Stat. 727, as amended by Sec. 1 of the Act of September 8, 1961, *supra* (12 U.S.C. 1430(c)).

and availability of loan funds * * *. " The Court having concluded in *Lincoln* (slip op. 12) that "[c]ertainly the FHLB stock is an asset and its acquisition is capital in nature", the Class C stock too must be considered an asset whose acquisition is subject to capital treatment.*

In sum, just as in *Lincoln* (slip op. 10), "the very recital of the facts and of the structure and operation of FSLIC's Reserves * * * itself provides an answer adverse to Lincoln's argument", so here, recitation of the facts and of the structure and operation of the Banks for Cooperatives system requires rejection of respondents' claim. And it is a matter of no consequence that respondents rely primarily on the interest provision of the Code (Section 163), rather than on the business expense provision (Section 162). Since the payments for Class C stock result in the creation or enhancement of an asset, they are not deductible under any Code provision.

* The court below held that the Class C stock had no intrinsic value; that is, that respondents derived no intangible benefit from the stock by, among other things, being able to borrow from the Bank. As the court viewed the matter, each respondent derived the full benefit of stock ownership by purchasing a single qualifying share of Class C stock, which made it eligible to borrow from the Bank. This analysis is squarely inconsistent with this Court's recognition in *Lincoln* of the permanent value of Federal Home Loan Bank stock, completely apart from any value it might have as an income-producing asset. Of course the additional shares of Class C stock had permanent value. If respondents and other farm cooperatives had not purchased the stock, then, given the government's desire to withdraw its capital from the Banks for Cooperatives system, there would have been no pool of capital and no cooperative bank from which respondents could have borrowed funds in times of need.

III

There are no significant factual differences between this case and *Lincoln* that could justify a difference in result. In each, as we have seen, the disputed payments were made under compulsion of federal statute. In each, the payor's purpose in making the disputed payments was the same as its purpose in making payments that concededly were deductible. Thus, in *Lincoln*, the taxpayer contributed to FSLIC's Secondary Reserve, and paid regular annual insurance premiums to secure current insurance on depositors' accounts; here, respondents contributed to the Bank's capital, and paid the stated interest on their loans to meet the Bank's conditions for continued borrowing. Neither in this case nor in *Lincoln* was there a market for the shares purchased. In neither case could such shares be liquidated except in unusual circumstances. The time when shares would provide a pecuniary benefit—in *Lincoln*, either in cash or in the form of future insurance coverage; here, by way of redemption—was uncertain. The shares were at all times subject to use to meet the losses of the institution in which they were held; they secured the obligations of their owners, in *Lincoln*, the taxpayer's obligations to pay regular annual insurance premiums in the future, and here, respondents' obligations to repay their loans to the Bank; and they carried with them no voting privileges whatever in *Lincoln*,⁵ and

⁵ FSLIC operates under the direction of the Federal Home Loan Bank Board whose members are appointed by the President. See Section 402(a) of the National Housing Act (12

only a single vote, regardless of the number of shares owned, in the instant case.

The court below relied on the foregoing factors in concluding that respondents' Class C stock had only nominal value, and that the cost of the stock, in excess of \$1 per share, was in substance nothing more than additional interest. These are the same factors which the taxpayer in *Lincoln* pressed upon this Court in support of its claim that its share of the Secondary Reserve was of no real value to it, and that its payments to that Reserve were essentially additional premiums for insurance on depositors' accounts. The Court found these arguments unpersuasive in *Lincoln* (see slip op. 12-14); they are no more persuasive here.

For the reasons stated, the judgment below should be reversed on the authority of *Commissioner v. Lincoln Savings and Loan Assn.*

Respectfully submitted.

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U.S.C. 1725(a)) and Section 17(a) of the Federal Home Loan Bank Act (12 U.S.C. 1437(a)).